Empowering Islamic Microfinance: Lesson from Group-Based Lending Scheme and Ibn Khaldun's Concept of 'Asabiyah

Abstract

Microfinance initiative is widely acclaimed as a new innovative approach to alleviate poverty. Through various microfinance mechanisms, the poor who were normally denied access to mainstream banking services are now able to benefit from various financial products and services. The emergence of microfinance requires an instructive examination from an Islamic perspective. The concern over credit provision and finance accessibility for the poor is inevitably relevant to Islamic bank that places greater social welfare responsibilities and religious commitments in order to achieve the Islamic economic objectives, including social justice, equitable distribution of income and wealth and promoting economic development. This paper therefore aims to examine the potential of group-based lending scheme of microfinance. It is argued that group-based lending approach is not a subject alien to Islam, as it is deeply inscribed in Ibn Khaldun's concept of 'Asabiyah or social solidarity. By adopting group-based lending approach, Islamic bank may offer various Islamic financial products and services without compromising on the issue of institutional viability and sustainability.

Keywords: Social solidarity, social capital, group-based lending, Islamic banking and finance.

INTRODUCTION

The last three decades witnessed a revolution in providing finance for alleviating poverty across the globe. The emergence of microfinance, the provision of small amounts of credit to the poor who usually fall outside the mainstream banking institution, is attracting growing attention from various parties including governments, bankers, practitioners, academicians and researchers.

The success in providing finance to the poor widely attributed to the mechanism used particularly the group-based lending scheme that has also captured the attention of development practitioners around the world. Group-based lending is a mechanism that allows the poor to access to financial services that they have historically been denied[1]. The formation of group among the rural poor is an essential part of the financing process directed to the poor. The group generates social capital that compensates for their lack of material assets. In turn, this investment in social capital creates creditworthy borrowers where none existed before and simultaneously attracting financing from financial institution to support their economic activities.

The key feature of group-based lending is social capital which is broadly defined as social networks, norms and trust that facilitates coordination and cooperation for

[1] The most quoted example is the experience of Grameen Bank in Bangladesh, which lends only to the poor. The bank enjoyed considerably higher repayment rates than similar credit programmes using traditional lending practices. Hosseun (1998) reports that the Grameen Bank has a repayment rate in excess of 95%.

mutual benefits (Putnam 1993). In other words, social capital refers to the internal social and cultural coherence of society, imbuing qualities like sense of belonging, group loyalty, good will, sympathy, respect for others and teamwork among people and the institutions in which they are embedded. These salient features of social capital can be utilized by the poor both as a creation of human capital (Coleman 1988) and a substitute for physical capital (Collier 1998). Trust and willingness to cooperate allows the poor to form groups and associations, which facilitate the realization of shared goals.

The emergence of microfinance industry coupled with the propagated group-based lending mechanism and social capital concept in the West today requires an instructive examination from an Islamic perspective. The discussion of social capital as an effective instrument in the present day group-based lending is directly related to Islamic concept of 'Asabiyah or social solidarity concept expounded by Ibn Khaldun in his famous book, al-Muqaddimah. Indeed, the social solidarity concept is deeply inscribed in social capital framework of group-based lending. Therefore, the concept of social capital and group-based lending approach can be benefited by Islamic banks who are currently looking for the most viable, effective and efficient ways to provide finance to the poor.

The purpose of this paper is primarily to review the group-based lending model in the light of Ibn Khaldun's social solidarity concept. Drawing on general works of group-based lending methodology and experiences, the paper will outline what is currently known about the characteristics of and approaches to social capital in which social solidarity concept is paramount. It is believed that by having a good understanding of this concept, Islamic banks may leverage on its potentials in providing financial products and services to the poor.

The remaining of this paper is organised as follows. Next section highlights the concept of social solidarity as expounded by Ibn Khaldun. The relevance and its implication to the current development of social capital is further elaborated in section 3. While section 4 reviews some theoretical issues on the existing numerous barriers to finance the poor, section 5 discusses the potential of social capital in enforcing group-based lending mechanism to overcome such barriers. Fittingly, the conclusion is in the final section.

IBN KHALDUN'S SOCIAL SOLIDARITY CONCEPT

Ibn Khaldun in his al-Muqaddimah postulates the necessity to have 'asabiyah in constructing a strong civilisation. 'Asabiyah or social solidarity or *'espirit de corp'* can be broadly defined as the state of mind that makes individuals to identify with a group and subordinate their own personal interests to the group interests (Ibn-Khaldun 1995).

According to Ibn Khaldun, human being by nature are social being who prefer to live together, cooperate and helping each other. However, due to numerous worldly temptations and motivations, individuals sometime acting to serve their own self-interest, thereby undermining the interest of the society at large. In his writings, Ibn Khaldun asserts that 'asabiyah or social solidarity was more evidenced and much stronger in nomadic tribes. This is due the fact that nomads lead a very simple life and do not know anything of luxury.

In contrast, sense of solidarity was less evidenced in urbanite society where luxuries were highly demanded. Due to shortages of such resources, individuals tend to compete with each other in negative ways. Extravagant lifestyles and preference for luxury goods also have deleterious effects of the morality of the people. In his words:

> “*Immorality, wrongdoings, insincerity and trickery, for the purpose of making a living in a proper or an improper manner, increase among them. The soul comes to think about (making a living), to study it, and to, use all possible trickery for the purpose. People are now devoted to lying, gambling, cheating, fraud, theft, perjury and usury”*. (Ibn Khadun, p.293)

Therefore, it is necessary to instil ‘asabiyah in people to keep them together, to promote altruism and sense of cooperation which ultimately generates social harmony. It may also serve as a decisive and unifying force in the rise and development of a civilization (he uses the word ‘umran to imply this) (Ibn Khaldun, p.102-103). Indeed, ‘Asabiyah binds groups together through a common language, norms, trust, culture and code of behaviour. Therefore, a society imbued with a sense of social solidarity fulfils its primary purpose to function with integrity and cooperate for mutual benefits and common goals (Ibn Khaldun, p.105).

In Islam, the term ‘asabiyah is used to connote two different meaning. The first meaning identifies ‘asabiyah as a social solidarity which is in harmony with the concept of brotherhood in Islam. This type of ‘asabiyah is praiseworthy since it encourages people to cooperate with each other for common objectives, restraint their self-interest, and fulfil their obligations towards each other. The following Quranic verse attests to this:

> “And cooperate in righteousness and piety, but do not cooperate in sin and aggression: (Al-Quran 5:2)

The second meaning of ‘asabiyah is ‘asabiyah jahiliyah referring to the blind and prejudiced loyalty to one’s own group. This leads to the favouring of one’s own group, irrespective of whether it is right or wrong. This type of ‘asabiyah is blameworthy, having tendency to promote injustices, inequities, mutual hatred and conflict. The Prophet (p.b.u.h) made a clear distinction between these two types of asabiyah in a hadith:

> It was reported by Ibn Majah from the father of Fusaylah, that the Prophet, peace be upon him, was asked whether the love for one’s own qawm (group, tribe or nation) constituted under the meaning of ‘asabiyah. He replied: “No! ‘asabiyah is rather the helping of one’s qawm in zulm (injustice).”

Undoubtedly, Ibn Khaldun uses the word ‘asabiyah in the Muqaddimah to imply the positive ‘asabiyah or social solidarity strongly premised in Shariah. He asserts, social solidarity becomes an irresistible power if it is grounded on the religious paradigm. Hence a sense of solidarity of any group or tribes can only make a real impact if supported by religion and not otherwise.

Justice: A Hallmark of the Islamic ‘Asabiyah

The core value in the Islamic system and worldview is justice coupled with beneficence. Ibn Khaldun asserts that justice as the defining characteristic of Islamic life and society, and as an indispensable part of the legal, social and economic progress (Ahmad 2003). Moreover, Islam stresses that justice should not only be rooted in the system of society but should also resonate through all levels of social life, in all relationships and dealings, from the family to the state.

The concept of justice is integral in the understanding of the concept of social solidarity or ‘Asabiyah expounded by Ibn Khaldun. It establishes equilibrium by way of fulfilling rights and obligations and by eliminating excess and disparity in all spheres of life. For instance, the benefits and costs of any scheme of social cooperation must be shared in proportion to the contribution made by each participant. Furthermore, individuals must be guaranteed equal rights and opportunities for their basic needs of food, housing, education, health, transport and employment (Parvez 2000). Society must also make provisions for those who, because of their physical disability cannot reciprocate in equal measure the benefits accruing to them from social cooperation nor bear the costs (Naqvi 2003)[2]. The intense commitment of Islam to justice and brotherhood demands the Muslim society to take care of the basic needs of the poor and those who are less-privileged in society (Rice 1999). The Islamic institution of zakah is an example of compulsory charitable-giving specially designated to facilitate the care of all members of society.[3]

Thus, Ibn Khaldun’s concept of social solidarity has a great implication on how human beings conduct their affairs. They can choose either to be selfish or socially entrenched individuals. The latter will definitely have a positive impact on the well-being and prosperity of an entire community. The sense of social solidarity implies that human interactions should be based on trust, equity and justice. They should not attempt to dominate or wrong each other; instead cooperate and support each other towards fulfilling their role of God’s vicegerency on earth. Therefore, the right attitude towards human beings is not ‘might is right’ struggle to serve only one’s own ‘self-interest’, or ‘survival of the fittest’[4] but the mutual sacrifice and cooperation to fulfil the basic needs of all, to develop the entire human potential and to enrich human life.

‘ASABIYAH AND SOCIAL CAPITAL CONCEPT

The preceding section has discussed the idea of ‘asabiyah or social solidarity as proposed by Ibn Khaldun. In a sense, ‘asabiyah, as a unifying force, is analogous to the modern concept of social capital. Indeed, the idea of social capital has captured much attention and has been applied to a variety of issues in recent times.

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[2] Naqvi (2003) asserts that meritocracy and feudalism denote injustice which blindly emphasise on ‘equality of opportunity’ without recognising the natural differential in intellectual endowments and abilities of different individuals in society. This, he argues, would essentially result in extreme inequalities of social, political and economic conditions. See Naqvi (2003).

[3] The Islamic jurists have unanimously held the view that it is the collective duty (fard kifāyah) of the Muslim society to take care of the basic needs of the poor. In fact according to Shatibi, this is the raison d’être of society itself. See Chapra (1992).

[4] Hassan (1996) also asserts that the philosophical foundation of a society based on secular self-interest or selfish point of view will do more harm as those in the position to manipulate will do so in order to achieve success in life at the expense of others. See detail discussion in Hassan (1996).

Coleman (1988) and Putnam (1993) were among the first to popularise the term 'social capital' in the sociological literature. Coleman (1988) introduces the concept of social capital in attempt to reconcile the two contradicting intellectual streams in the description and explanation of social action. On one stream (represented by the work of most sociologists) perceives the economic actor as socialized and action as governed by social norms, rules and obligation. Another stream (represented by the work of most economists) perceives the economic actor as having a wholly self-interest goal of maximizing utility[5]. On the other hand, Coleman's definition of social capital mainly focuses on its function, which constitutes a particular kind of resources, inherent in the structure of relations between actors and among actors. These resources include trust, information channels, norms and effective sanctions.

As an extension to the Coleman's concept of social capital, Putnam (1993) defines social capital as "*those features of social organisation such as networks, norms, and trust that facilitate coordination and cooperation for mutual benefits*". In other words social capital refers to the internal social and cultural coherence of society, the trust, norms and values that govern interactions among people and the institutions in which they are embedded.

Intuitively, social capital stands for the ability of an individual to secure benefits by virtues of membership in social networks, groups or social structures. The social capital recognises a sense of identity and common purpose within a group. Like Ibn Khaldun's 'asabiyah, social capital concept is not a sense of identity alone. Instead, aspiration, loyalty, trust, norms and devotion are also prerequisites for the preservation of the group.

In the light of the preceding discussion on the concept of 'asabiyah or social solidarity, the notion of social capital assumes a broader and more holistic significance especially to the Muslim community, since it is based on religious doctrine. Islamic guidance enshrined by its principle of justice brings about a balance between the rights of individuals and their duties and responsibilities towards others (Parvez 2000), and between self-interest and altruistic values (Naqvi 2003).

Islam recognises self-interest as a natural motivating force in all human life. But self-interest has to be linked to the overall concept of goodness and justice. Therefore, individuals, imbued with a sense of justice, are not expected to abandon their individual interests altogether. In other words, altruism will not push individuals beyond justice. However, Islam attempts to create a culture that binds individuals and families into a community so that a natural infrastructure for providing support and help to those in need is developed.

Islam, in fact, lays down a moral framework for effort, spelling out values and disvalues, what is desirable and what is reprehensible from a moral, spiritual and social perspective (Chapra 2000a; Ahmad 2003). The concept of reward is also

[5] Both streams have their own serious defects. By overemphasizing the conception of action as wholly a product of the environment, the sociologists tend to undermine the actor's own action that give him a purpose or direction. In contrast, the economist's principle of rational action tends to ignore the social context; norms, interpersonal trust, social networks and social organization which may partly shape the actor's action. For details analysis refer Coleman (1988)

broadened by incorporating within it, reward in this world and reward in the Hereafter. This provides a strong and self-propelling motivation for good and just behaviour, without denying the natural instincts for personal gain (Ahmad 2003). Hence, moderation and concern for the needs of others, along with ones own, become an integral part of the Islamic perspective of social capital.

The forthcoming sections shall review the important implication of social capital to the development of group-based lending mechanism which aims at providing finance to the poor who are normally denied access to credits and other conventional financial services.

BARRIERS IN FINANCING THE POOR

Pichke (1991) highlights that finance is primarily social based on the Latin root word of credit, *credere* which denotes the meaning of to believe or entrust. Indeed, the essence of every financial transaction is the invocation of an element of trust. The contacts between a borrower and a lender will only be honoured if the element of trust exists in such transactions. According to Arrow (1972), *"Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. It can be plausibly argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence."* The basis of the trust depends on two critical elements; first is the applicant's reputation as a person of honour (Diamond 1991) and; second is the availability of enough capital or collateral against which claims can be made in case of default (Holmstrom and Tirole 1993).

The essence of conventional profit-maximization banks as financial intermediaries that provide financial services to the people hinge upon these two elements. As the formal lenders, risk-averse banks will only be willing to lend if these two elements that serve as a basis of trust in their reciprocal relationship with their clients (as borrowers) exist.[6]

However these two elements poised important impediments to the poor especially in the rural areas to access into credit market. The poor are usually perceived by the 'profit-orientated' conventional banks as high-risk borrowers due to the inherent difficulties in assessing their creditworthiness at the same time their inability to provide collateral to pledge against any potential risk.

These traditional formal lenders faced with borrowers whom they do not personally know, who do not keep written accounts or 'business plans' and who want to borrow small and uneconomic sums (Jacklen 1988); thus exposing them to very high risks due to the inherent screening problems faced by the lenders at the same time make the project appraisal become too expensive(Rhyne and Otero 1992).

Most formal intermediaries like commercial banks also regard low-income households as 'too poor' to save, thus further accentuates the risk of supplying credits

[6] For instance, the bank is able to assess the reputation of the borrowers based on the bank's intimate knowledge embedded in the clients personal accounts as well as other documented history of past borrower behaviour. At the same time the clients have material value such as properties or any valuable assets as collateral to pledge against risk.

to them (Adams and Vogel 1986; Sinclair 1998)[7]. Furthermore, no insurer is willing to insure against possibility of non-repayment due to natural and commonest hazards which afflict small producers in developing countries; for example, drought, livestock disease and breakdown of equipment (Hulme and Mosley 1996)[8]. The risk exposure in supplying credits to the poor clients further exacerbate due to the inherent difficulty for the commercial financial institution to diversify their portfolio. For example, most of the rural clients who derive their incomes from agriculture need to borrow in the pre harvest season, making it difficult for banks to diversify their portfolio (Zeller and Sharma 1998).

Financial institutions inevitably suffer high transaction costs due to asymmetric information problems which naturally appear in the financial transactions. These costs related to the searching costs, monitoring costs and enforcement cost which are directly related to the information problems incur in the rural financial markets. The uncertainty regarding the ability of borrowers to meet future loan obligations, inability to monitor the use of funds and demand for small sum of loans by the rural households further reinforces the higher units of transaction costs, which is characterised by fixed costs[9] (Braverman and Guasch 1986; Zeller and Meyer 2002).

BUILDING SOCIAL CAPITAL IN GROUP-BASED LENDING

Many writers, including Bennett and Cuevas (1996), Fukuyama (1995), Coleman (1988) and Collier (1998), believe that overcoming the many barriers that have prevented large potentially productive segments of the population from access to formal financial institutions may require more than conventional financial intermediation. Integrating under-served groups into the formal financial markets may entail some measure of up-front investment to develop the human resources (confidence, knowledge, skills and information) among the clients at the same time to build local structures that help them to link with financial institutions.

These two measures are naturally embedded in social capital structure. The salient features of social capital can be utilized by the rural poor both as a creation of human capital (Coleman 1988) as well as a substitute for physical capital (Collier 1998).

[7] In the case of Britain, the poor devotes only 1.5% of their incomes to life insurance, savings and investment. The inference made by Sinclair (1998) from the figures is that savings are regarded to be a luxury for the poor to save almost nothing of their income. One of the reasons is that the poor perceive little point in saving on their own when they expect to avail themselves of this benefit if they have saved nothing. Moreover the poor is lacking the incentive and resources to make the investment that strengthen their demand for consumption in old age. For detail discussion refer Sinclair (1998)

[8] In their analysis, Hulme and Mosley hypothesize that the credit market fails if poor people –whether farmers or micro-entrepreneurs are unable to borrow for socially beneficial projects due to any of four reasons: Firstly, no lender is willing (or legally permitted) to pass on the extra costs associated with lending to unknown customers in small quantities; secondly no insurer is willing to compensate for borrowers' and lenders' risk aversion (and for the presumed absence of collateral) by offering insurance against non-repayment due to natural hazards; thirdly, even if the first two reasons are untrue, potential borrowers are unwilling to borrow because of their risk-aversion attitude; and finally, social and private values of cost and benefit diverge because of externalities or otherwise, so that some projects which are socially profitable do not survive on the basis of private costs and returns. For details see Hulme and Mosley (1996)

[9] Transaction costs have a large fixed-cost component, so unit costs for smaller savings deposits or smaller loans are high compared with those for larger transactions. The conventional banks are structured to handle much larger individual transactions or loans than those required by the poor. Lending to the poor who normally demand small amount of loans is regarded expensive because of high overhead costs. See Jacklen (1988), Zeller and Meyer (2002)

Trust and willingness to cooperate allows the poor to form groups and associations, which facilitate the realization of shared goals particularly to be linked with financial institutions. Fukuyama (1995) further elaborates the significance of social capital building in the institutional setting especially when addressing the issue of eradicating poverty by emphasising the concept of 'trust' within the society and organizations. In his perspectives trust is hailed as the paramount social virtue, the creator of prosperity, by which opportunism can be reduced and transaction costs can be minimized.

The following summarises the many advantages of social capital that have been discussed in the economic development and sociology literature. These advantages have internal and external dimensions. The former reflects the advantages and benefits of social capital building to the organization, while the latter directly relates to the empowerment of the target groups under consideration. Some of the benefits and advantages are briefly discussed as follows:

Enforcing Group-based Lending

Bridging social capital (by enforcing shared norms, trust and values of behaviour) through formation of group-based lending among rural poor communities will improve access to physical capital, particularly in the absence of collateral. Peer Guarantee Mechanism, which is the essence of the group-based lending, has proven empirically as an effective way of designing an incentive-monitoring system in the presence of costly information[10]. It introduces shared liability and pressure from social groups as a replacement for security (i.e. collateral) and business appraisals.

This mechanism proves to be an effective and efficient way to reduce the transaction costs in credit delivery and disbursements (searching, monitoring and enforcement) of the lender by shifting onto the groups as well as securing loan repayments. Besley and Coate (1995) suggests that group lending may also harness 'social collateral' which constitute a powerful incentive device to yield higher repayment rates than individual lending. The self-selected group members share a common interest in gaining access to credit and savings services, and possess enough low-cost information to adequately screen each other and apply sanctions to those who do not comply with the rule[11].

Hence it lowers transaction costs, reduces financial risk and facilitates a greater range of market transactions in outputs, credit, land and labour which can in turn lead to

[10] Grameen Bank (Bangladesh) which started operation in 1976 has now a daily loan volume of $1.5 million and has 98 percent repayment rate, appears to be a model of success in applying this mechanism. One of the distinctive characteristics to the Grameen Bank is that loans are made to self-formed groups of approximately five farmers, who are mutually responsible for repaying the loans. Additional amounts of loans will be further granted if all members of the group have settled all the outstanding amounts. In such arrangement, Stiglitz (1990) argued that the Grameen Bank devised an incentive structure called 'peer monitoring' whereby the others within the village do the monitoring on their behalf by exploiting the local knowledge of the members of the group. However Besley and Coate (1995) and Hulme and Mosley (1996) assert that even though the group-lending may prove to have a positive effect on enhancing the incentive of loan repayment, it may have perverse effect when the whole group defaults, even when some members would have repaid individually.

[11] In their model, Besley and Coate (1995) postulate a social penalty function that describes the punishments available within a group rather than the bank. This social penalty implies that members in the community who do not comply with the norms, trust and values of the communities can be ridiculed or ousted from the family. This may constitute a powerful incentive device, since the costs of upsetting other members in the community may be high.

better incomes. For example strong social link among borrowers may increase their ability to participate in credit transactions that characterized by uncertainty about compliance[12]. In particular, social capital could lead to a better flow of information between lenders and borrowers and hence less adverse selection and moral hazard in the credit market. Social capital also potentially expands the range of enforcement mechanisms for default on obligations in environments in which recourse to the legal system is costly or impossible. Again, trust (social capital) plays a paramount role in the formation of group lending success, particularly in the absence of collateral. (Stiglitz 1990; Otero and Rhyne 1994; Besley and Coate 1995; Krishna, Uphoff et al. 1997; Bhatt and Tang 1998; Collier 1998; Zeller and Sharma 1998; Narayan and Pritchett 1999).

Informal Safety Nets

Social Capital may act as informal safety nets or informal insurance that mitigates the consequences of any hazards and adverse outcomes. These safety nets are especially important due to several reasons including severe income fluctuations, erratic natural disasters, like crop and human diseases, and weather-dependant availability of food.

The informal safety nets are exhibited through strong social ties and networks within the communities and the willingness to share risk among villagers. In fact the essence of social solidarity in Islam obligates Muslims to help their fellow afflicted human being especially at times of distress. A beautiful hadith of the Prophet p.b.u.h. delineates this responsibility:

> *"Whoever relieves a believer of some of the distress of this world, Allah will relieve him of some of the distress of the Day of Resurrection. Whoever eases an insolvent's loan, Allah will make things easier for him in this world and in the Hereafter. Whoever conceals a Muslim's faults, Allah will conceal his faults in this world and in the Hereafter. Allah will help a person so long as he helps his brother." (Ibn-Baz 2005)*

Therefore, the availability of social capital in the communities induces risk averse borrowers amongst the poor households to pursue higher return and adopt profitable production technology and techniques (Townsend 1994; Morduch 1999; Narayan and Pritchett 1999).

Mobilising Infrastructure

Social Capital by means of norms of civic cooperation amongst the rural and poor people can mobilize better services from the state; improve infrastructure; and provide access to wider markets and formal credit systems. In Putnam's analysis, he finds that the greater citizen's civic cooperation and trust (exemplified through joining football clubs and choral societies) the faster the regional government is in reimbursing healthcare claims. In other words social capital may improve economic outcomes indirectly since it appeals to the political interest of the government. (Putnam 1993; Knack and Keefer 1997)

[12] In Tanzania, social capital at the community level impacted poverty by making government services more effective, facilitating the spread of information on agriculture, enabling groups to pool their resources and manage property as a cooperative, and giving people access to credit who have been traditionally locked out of formal financial institutions. For details data analysis and empirical studies refer Narayan and Pritchett (1999)

Promote Efficiency

Organizations may also reap the benefits from social capital by reducing transaction costs internally especially those that are associated with lack of trust due to numerous potential inherent uncertainties in the social-economic organizations, such as co-ordination and motivation costs among stakeholders. Although external parties may perceive the non-profit status of a social enterprise itself as a sign of trust (Hansmann 1980; Easley and O'Hara 1983; Hansmann 1996), it is becoming increasingly clear that this status alone is insufficient in building relationships of trust[13]. Therefore, the mobilization of social capital by establishing trust through group formation (teamwork) may promote cooperation and coordination amongst the various stakeholders within the organization, thereby lessening the incentive of opportunistic behaviour. Workers and shareholders in a firm are likely to feel an increased sense of pride in their work if they are part of an entity which strives to make a positive contribution to its surrounding communities which are often considered as home to firm staff. This will inadvertently improve the efficiency of an economic organization.(Fukuyama 1995; Laville and Nyssens 2001)

In sum, social capital (e.g. through group-based lending initiatives) can play an important role in social banking institution that aims at alleviating poverty. In general, the building-up of social capital by an institution is to ensure that it economises transaction costs for both lenders and borrowers.

From the economic point of view, social capital economises the transaction costs in credit delivery associated with searching for loanable funds, designing credit contracts, engaging in community outreach, screening borrowers, assessing project feasibility, evaluating loan applications, providing credit training to staff and borrowers, and monitoring and enforcing loan contracts. This is achieved mainly through shifting the transaction burden to group members.

From borrower's perspective, transaction costs which include negotiating with the lender, filling out necessary paperwork, transportation to and from the lending agency, time spent on project appraisal and meetings, monitoring group activities and enforcing group rules can be minimized by the social capital elements imbued in their group formation in which joint responsibilities and liabilities are prerequisite.

The discussion on group-based lending mechanism which exploits social capital as an essential innovative programme for building a viable mechanism in financing the poor has been extensively discussed in the microfinance literature. The three most quoted and prominent types of group lending arrangements are; First, loan granted to the group (who then responsible to distribute to all of the members) at the same time jointly liable for repayment; Second, loan granted to individuals in a group and group is jointly liable for repayment and; Third, loans given to individuals in a group, and it is the individuals not the other group members, who are liable for the loan. For convenience we label the three arrangements as Type 1, Type 2 and Type 3 group lending respectively. Table 4.1 summarizes their most distinctive features.

[13] The absence of profit motive does not prevent managers of organizations from pursuing objectives other than explicit profit and behaving in the manner that do not necessarily coincides with the interests of the beneficiaries. For example they may divert excessive remuneration to staffs or themselves or simply stray from its original objectives.

Table 4.1 Comparative Features of Group-Based Lending Arrangements

	Type 1: Group Loan-Joint Liability	**Type 2**: Individual Loan-Joint Liability	**Type 3**: Individual Loan-Individual Liability
1. Basic Procedures	A group of 3-10 individuals is self-formed. Loans are given to the group who collectively guarantee loan repayment, and access to subsequent loans depends on successful repayment by all group members.	A larger group from 50 to 200 or more. May be regulated (if credit union) or unregulated (if self-help groups). Most of the time the lender will have to outreach to prospective borrowers. Loans are made directly to individuals within the group who collectively guarantee loan repayment.	Resemble the traditional lending methods in which funds are loaned to individuals based on credit and collateral checks. Individuals and not the group are responsible for loan repayment. Nevertheless borrowers are required to form groups of typically 3 members in order to receive credit.
2. Group's Duty	Select group members and leaders, assess, decide and approves the amount of loans needed by each member, disburse the granted loan to each member, collectively guarantee loan repayment and collect payments. Groups also sanction those who do not pay.	Organize weekly meeting at agency's centre. Fewer loan disbursement responsibilities (i.e. group project appraisal, group-needs assessments). Group responsible in monitoring, sanctioning and repayment by all group members.	Provide the lender information regarding group members' creditworthiness or project-risk and to provide each other with assistance in business contacts.
3. Lender's Role	Low involvement. Providing basic business training; interacting with group representative for record keeping and collection.	Moderate involvement Outreach prospective borrowers, take a lead role in screening and evaluating individual loan request and project appraisal. Keeping track of individual loans and providing basic business training.	High involvement. Lenders must assume most of the credit delivery responsibilities from screening, monitoring to enforcing loan disbursements and repayments. Extensive business training also needed to ensure borrowers' capability for repayment.
4. Guarantee Mechanism	Peer guarantee Progressive lending: Expand credit limits based on previous repayment record. Compulsory savings.	Peer guarantee: Strong social pressure and sanctions. Progressive lending Voluntary and compulsory savings also emphasized.	Physical guarantee (land, vehicle, savings). Progressive lending Prompt repayment discount (or late payment penalties)
5. Element of social capital	Very high due to the mutual trust and respect as members know each other well and share same set of social norms and conventions. E.g. neighbours, workmates etc.	Moderate due to geographical factors such as remoteness and scattered settlements.	Low because group members are usually unfamiliar with each other owing to a lack of spatial proximity
6. Models available	Solidarity groups, village banks, microfinance institutions. e.g. Grameen Bank, BRAC Bangladesh, ACCION International, BancoSol Bolivia	Credit unions, cooperatives e.g. SANASA Sri Langka Credit Solidaire Burkina Faso, Cameroon Credit Union Movement, Smallholder Agricultural Credit Administration, Malawi, Banques Populaires du Rwanda, Cooperatives d'Epargne et de Credit du Togo.	e.g. Bank Rakyat Indonesia Unit Desa (BRI-UD), Kredit Usaha Rakyat Kecil (KURK) Indonesia, Badan Kredit Kecamatan (BKK) Indonesia.

Source: (Gurgad, Pederson et al. 1994), (Holt 1994), (Magill 1994), (Reed and Befus 1994), (Berenbach and Guzman 1994), (Bennett, Goldberg et al. 1996), (Hulme and Mosley 1996), (Edgcomb and Barton 1998), (Bhatt and Tang 1998)

As shown in the table, the transaction costs imposed by the three types of group-based lending may vary according to the degree of social capital accessibility in the region. When social capital is very high, Type 1 group-based lending is more preferable, since shifting responsibilities and transaction burdens onto groups are more plausible. This is because groups characterised with high level of trust and information availability will help bank to internalize transaction costs associated with the credit delivery responsibilities (such as searching, screening, monitoring and enforcing loans).

On the other hand when social capital is not as high due to lack of familiarity and information, bank should therefore choose Type 2 arrangement so that lenders assume more of the responsibilities of loan disbursement and give less responsibilities to the group. This may reduce moral hazard on part of the borrowers who do not belong to strong social-ties groups. Finally when social capital is low, Type 3 group-based lending is more reasonable since lenders maximize their involvement and minimize the group's participation in the crucial stages of loan disbursements.

It is therefore argued that only those types of group-lending programmes that economize transaction costs for both the lenders and the borrowers have a chance at being viable. This implies the need to consider the social context including cultural variation and economic conditions of a region as a key to design viable group lending arrangements (Bhatt and Tang 1998). Any attempt to transfer or replicate a successful group-based lending model of one institution of a country to another must be taken with caution (Mutua, Nataradol et al. 1996). The difference between the experiences of the Kenyans and Bolivians with group lending approach could be a good example in this respect. K-REP's experience indicates that the group-based approach of lending to individuals, which Bolivia's BancoSol has found effective is of limited use in Kenya[14].

It is also not necessary for choosing one type of programme while abandoning others. Bank may adopt hybrid approach using the combination of two or more approaches based upon the characteristics of the target market. Bank Shinta Daya of Indonesia is an example of hybrid programmes. This private rural bank adopts hybrid approach by employing both Type 1 and Type 3 group-lending programmes, which is working quite well[15] (Seibel and Parhusip 1998).

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[14] When the group-based lending method was introduced in Kenya, K-REP's staff expected that group savings guarantees and peer pressure would be effective to minimize defaults. Nevertheless, the results turn otherwise as compulsory savings and the use of savings as security directly impacted repayments. Moreover borrowers who are otherwise creditworthy become defaulters when they forfeit savings on behalf of their group members. Some consider the use of peer pressure to enforce payments an unfair shifting of the responsibilities of a lender onto their clients. K-REP also faced problems with the practice of delegating credit assessment to the groups, because group members are not objective when assessing applications from their peers. Finally, it is difficult to screen out deceivers from honest borrowers under this scheme. See Mutua, Nataradol, et al. (1996) for details evidence.

[15] Bank Shinta Daya was established with private capital of US$40,000 in 1970 and financed its expansion from its profits. Its net worth in December 1995 was Rp. 495.8 million (US$215,000), comprising Rp 179.5 million in capital and Rp 316.3 million in retained earnings. Group members comprises the poor in the rural area represents 49 percent of the bank's direct and indirect borrowers and 24 percent of the bank's depositor. For the bank both types of group-lending are profitable. But the individual technology is more profitable than the group technology as 94 percent of the bank's profits are derived from its individual lending and only 6 percent from group lending. Nevertheless, according

Apart from various lending technologies that bank should consider in preserving its viability while addressing the poor clients, another important aspect is to provide demand-oriented financial services. The scope of lending services offered to the poor and rural households must address not only production and income-generating activities but also consumption needs such as health, education, nutritional food and other social obligations (Diagne and Zeller 2001).

Flexible and innovative refinancing and repayment procedures must also be offered to accommodate unanticipated events typically affecting poor households especially in rural area. This may require unbureaucratic access to emergency loans or the build-up of emergency funds by group-based lending members, which possibly be pooled through a regional or national second-tier institution (Zeller and Sharma 1998). Only by addressing the needs and the real demand of the vulnerable groups in providing the financial services, a social banking institution can achieve better impact and outreach while preserving its viability[16].

IMPLICATIONS AND CONCLUSION

This paper discusses the salient characteristics of group-based lending, which is one of the most important features of successful microfinance initiatives. The main characteristic discussed in the concept of social capital and how this concept directly related to Ibn Khaldun's social solidarity or 'Asabiyah. In the paper, we have argued that both 'asabiyah and social capital promote positive values like sense of belonging, teamwork, cooperation and more importantly trust. Such values which are grounded on the religious paradigm may strongly function as sources for successful operation of group-based lending mechanism.

As reviewed in this paper social capital is critical for the successful design of group-based lending programmes to increase the access of poor or low-income earners to credits. The social capital as reflected in strong association activity is believed to be an effective tool to reduce transaction costs and lower exposure to numerous financial risks in relation to providing credit to the rural poor.

Social capital is deemed to be an effective tool to foster a better flow of information between lenders and borrowers and hence less adverse selection and moral hazard in the credit market. It also potentially expands the range of enforcement mechanism for default on obligations in environments in which recourse to the legal system is costly or impossible. Therefore, social capital may increase the ability of borrowers to participate in credit transactions that involve uncertainty about compliance and numerous financial barriers.

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to the bank's management, by providing financial services to group members with microenterprise activitities, it contributes to their growth. As the members' microenterprises grow, so will their business with bank. See Seibel and Parhusip (1998).

[16] In the microfinance impact studies conducted by Diagne and Zeller (2001) on several rural financial institutions in Malawi, it was found that no significant impact of access to credit on the per capita incomes, food security and nutritional status of credit programme members. This is because the rural financial institutions in Malawi covered in their study do not offer financial products, such as consumption credit and precautionary savings options, which could eventually have a direct effect on consumption or on nutritional status. See Diagne and Zeller (2001)

The discussion of group-based lending scheme in the light of social capital concept is imperative for a successful design and implementation of Islamic microfinance initiative. Indeed, Islamic banks may emulate the various approaches of group-based lending scheme in designing their Islamic microfinance or any efforts to provide Islamic banking products and services to the poor. It is strongly believed that, unless Islamic banks expand their financial frontier to include the poor, their noble socio-economic objectives to promote social justice, equitable wealth distribution and poverty alleviation can never be materialised.

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